Nepal Grameen Bikas Bank Limited

ICRA Nepal assigns [ICRANP] IPO Grade 4 to the proposed further public offering (equity shares) of Nepal Grameen Bikas Bank Limited

Facility/Instrument	Issue Size	Grading Action (July 2017)
Further Public Offer (Equity)	NPR 97.50 million	[ICRANP] IPO Grade 4 (Assigned)

ICRA Nepal has assigned an "**[ICRANP] IPO Grade 4**", indicating below-average fundamentals to the proposed further public offer (FPO) of equity shares amounting to NPR 97.50 million of Nepal Grameen Bikas Bank Limited (NGBBL). ICRA Nepal assigns IPO grading on a scale of IPO Grade 1 through IPO Grade 5, with Grade 1 indicating strong fundamentals and Grade 5 indicating poor fundamentals. For the grading categories 2, 3 and 4, the sign of + (plus) appended to the grading symbols indicate their relative position within the grading categories concerned. Thus, the grading of 2+, 3+ and 4+ are one notch higher than 2, 3, and 4, respectively. NGBBL has proposed to come out with the FPO of 975,000 number of shares of face value NPR 100 to general public at par. The issue is being made to ensure a minimum public shareholding of 30% (currently at ~18%) in banks and financial institutions (BFIs), as required by the regulations.

The grading factors in NGBBL's strong promoters profile (~35% holding by Government of Nepal (GoN), ~4% holding by Nepal Rastra Bank (NRB) and ~17% holding by NRB licensed Class A commercial Banks) which is expected to strengthen the governance and funding profile of NGBBL. The grading also factors in NGBBL's large scale of operation encompassing wide geography (186 branches across 53 districts of Nepal as on mid-April 2017) and customer base which is expected to support incremental credit growth.

The grading is however constrained by change in regulatory environment which could affect the incremental funding profile and profitability of NGBBL. Through Monetary Policy of FY17, NRB has directed class A commercial banks to maintain 2% (out of total 5%) deprived sector lending (DSL) target in the form of direct loans (rest 3% could be through intermediaries). As on mid-April 2017, class A commercial banks accounted for ~78% of the total bank borrowings of NGBBL. Additionally, lending yield for retail MFI has been capped at 18% (hitherto unregulated) with effect from mid-July 2017 which will prevent MFIs from passing on the increased cost of funds to the ultimate borrowers. Nonetheless, the grading positively takes note of the recent regulatory relaxation of allowing addition of up to 4% operating costs to cost of funds in maintaining the 7% lending spreads as introduced by Monetary Policy of FY17.

The grading further remains constrained by weak financial profile of NGBBL (with accumulated losses of NPR 469 million till mid-July 2016) and limited post-merger track record (since August 2014). Business and human resource (HR) integration of erstwhile regional Grameen Bikas Banks remains a challenge for NGBBL. Grading concern also emanates from relatively weak assets quality indicators (gross NPL[1] of 4.66% as on mid-April 2017), despite marginal improvement in recent years. Weak capitalization of NGBBL (CRAR of 7.15% as on mid-April 2017 in breach of regulatory minimum of 8%) also remains a concern although likely to be mitigated post FPO. The grading is also constrained by weak management information system (MIS)[2] of NGBBL which limits the extent of management oversight and control. Concerns also arise from the marginal profile of MFI borrowers and absence of centralized credit bureau in microfinance segment increasing the risk of loan duplication and overleveraging.

NGBBL was formed after the merger of erstwhile five regional Grameen Bikas banks. These regional Grameen Bikas Banks (established over 1993-1997) were promoted by Nepal Government and NRB in collaboration with NRB licensed BFIs to replicate the Grameen Model and increase financial access among the poorer sections of the community. Over the years of operation, most of these Grameen Bikas Banks faltered under rising NPLs and operational inefficiencies leading to large accumulated losses. As a measure to revive these ailing institutions, GoN and NRB initiated the process of merger among five

[1] Non-performing Loans
[2] Out of 186 branches only 93 branches have computerised system. Further, these systems are not integrated

regional Grameen Bikas Banks which was eventually concluded in August 2014. Due to accumulated losses and eroded net worth of most of the merging entities, NGBBL has a weak capitalization profile with CRAR (7.15% as on mid-April 2017) lower to regulatory minimum. Similarly, assets quality of NGBBL also remains weak (gross NPLs of 4.66% as on mid-April 2017) despite improvement since merger (gross NPLs of ~9% at the time of merger).

NGBBL follows group based lending model of microfinance for unsecured loans in addition to providing collateralized loans to its members. As on mid-April 2017, 87% of the loans were of unsecured group-guarantee based nature while ~13% was secured against collateral. With marginal borrower profile and unsecured nature of the loans, maintaining good asset quality will also remain challenge for the MFI sector and NGBBL as well over longer-term. NGBBL's credit portfolio growth has remained below industry average post-merger (CAGR ~24% over during FY14-9MFY17), due to greater focus on business consolidation. Nonetheless, wide customer base and low average ticket size (~NPR 55,000 as on mid-April 2017) provides scope for NGBBL to boost credit growth within the existing seasoned customer base. Incremental credit growth is also likely to remain supported by large below poverty line population in Nepal that act as target group for MFIs. NGBBL's asset quality remains weak vis-à-vis other established peers with gross NPLs of 4.66% as on mid-April 2017. Moreover, due to MIS constraint NGBBL does not track the non-NPL delinquencies which remains a big control lapse.

NGBBL's funding profile comprises of external borrowings and member's deposits. As on mid-April 2017, 68% of the total external fund comprised of borrowings and remaining 32% comprised of members deposits. High reliance on the borrowings can affect the funding profile, especially with the impending changes in DSL regulations. Average cost of borrowings for NGBBL has increased during past 6-12 months due to shortage of lendable funds in the banking industry. Proportion of members deposit remains lower to similar sized peers despite long track record of NGBBL (through erstwhile regional Grameen Bikas Banks). As on mid-April 2017, 63% of the deposits are of mandatory nature, subject to withdrawal restrictions while remaining deposits are of voluntary nature. As on mid-April 2017, NGBBL has borrowed from more than 35 lenders including 33 BFIs. GoN, NRB and Government owned commercial banks accounted for ~24% of NGBBL's borrowings as on mid-April 2017, indicating adequate funding support from promoters.

NGBBL has reported healthy profitability over past 12-18 months. The company has reported profits in each of the fiscal year following the merger in Q1FY15. Profit accruals has helped improve the capital fund and capitalization ratio of the company. During FY16, NGBBL reported return on networth of 55% which has moderated to 39% during 9mFY17 due to increase in net worth base by interim profit accruals. Profit levels remain supported by healthy lending yield (~20%) and low cost of fund (~5.50%) leading to healthy lending spread of 14-15%. Relatively high gearing level (given low capitalisation) and healthy rate of credit mobilisation (credit as a % of total assets of ~80%), this has resulted in healthy profit levels for NGBBL. However, going forward, profitability indicators are likely to come under pressure due to regulatory changes.

As on mid-April 2017, capital to risk assets ratio (CRAR) of NGBBL stood at 7.15% in breach of regulatory minimum capital requirement of 8%. It was caused by merger between erstwhile Grameen Bikas Banks most of which had depleted capital fund on account operating losses accumulated over the years. Proposed equity injection and retention of incremental profit accruals[3] is likely to improve the capitalisation profile. Thin capitalisation and inherent risk of microfinance business increases the vulnerability of the company towards probable credit shocks. Despite thin capitalization, gearing ratio of RSDC is moderate (~9 times as on mid-April 2017 much lower to regulatory maximum of 30 times). With proposed capital injection plan and retention of future profits, gearing level is expected to moderate.

Company Profile

NGBBL was incorporated in August 2014, after the merger of five regional level rural development banks viz; Purwanchal (Eastern), Madhyamanchal (Central), Paschimanchal (Western), Madhya-Paschimanchal (Mid-Western) and Sudur-Paschimanchal (Far western) Grameen Bikas Banks to

[3] as the company cannot distribute dividends before recovering the accumulated losses

operate as a national level class-D microfinance institution. Overall shareholding pattern of the bank constitutes of Promoters holding of 82% (mainly Nepal government ~35%, Nepal Rastra Bank (NRB) ~4%, NRB Licensed BFIs ~17%) and public shareholding of ~18%. The registered and corporate Office of the bank is in Butwal, Rupandehi, Nepal. The shares of the Bank are listed in Nepal Stock Exchange.

NGBBL has presence across 53 districts of Nepal through its 186 branches, five regional offices and one head office. NGBBL reported a profit after tax of ~NPR 246 million during FY16, over an asset base of NPR 7,662 million as on Jul-16 as against as against net profit of ~NPR 182 million during FY15 over an asset base of NPR 6,243 million as of mid-Jul-15. Bank reported profit after tax of ~NPR 196 million up to Q3FY17 over an asset base of 9,120 million as of mid-Mar-17. As on mid-Mar-17, NGBBL's gross NPLs stood at 4.66% and CRAR at 7.15%. On information technology front, ~50% of the branches of NGBBL are operating on manual system while in the remaining branches 2 kinds of software is being used viz- Empower and Pumori.[4]

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[4] Different software was being used by erstwhile regional Grameen Bikas banks at the time of merger which continues till date.